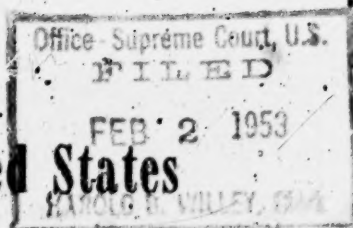


**LIBRARY**  
**SUPREME COURT, U.S.**



IN THE  
**Supreme Court of the United States**

October Term, 1952

No. 290

ERNEST A. WATSON and M. GLADYS WATSON,

*Petitioners,*

*v.s.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

On Writ of Certiorari to the United States Court of Appeals  
for the Ninth Circuit.

**REPLY BRIEF FOR THE PETITIONER.**

A. CALDER MACKAY,

523 West Sixth Street,  
Los Angeles 14, California,

*Attorney for Petitioner.*

ARTHUR MCGREGOR,  
HOWARD W. REYNOLDS,  
ADAM Y. BENNION,  
RICHARD N. MACKAY,  
CHARLES J. HIGSON,

*Of Counsel.*

Introduction .....	1
--------------------	---

## I.

Under the law of the State of California and a vast majority of the other states, the growing crops are held to be part of the real property where a conveyance of the real estate is made .....	2
--	---

## II.

The long continued silence of the Commissioner of Internal Revenue indicates it was the administrative policy that no allocation between trees and growing immature crop should be made and that such sales should be treated as sale of capital assets .....	4
---	---

## III.

The green, unsevered immature oranges were not and could not be property held by the taxpayer primarily for sale to customers in the ordinary course of her trade or business .....	5
A. The fact that the crop expectancy constituted an item of value in the lump-sum sale does not mean that petitioner therefore was selling a crop of oranges .....	7
B. The crop expectancy is appreciation in value of the land and trees. The Internal Revenue Code precludes allocation of this speculative value to the current crop .....	15
C. The green globules on the tree were neither inventoriable property nor of the kind or character of property which petitioner held primarily for sale to customers in the ordinary course of her trade or business .....	18

## IV.

All of the property sold by petitioner was held for more than six months .....	22
--	----

## TABLE OF AUTHORITIES CITED.

CASES	PAGE
Emerson, Isaac, 12 T. C. 875.....	11
Fawn Lake Ranch Co., 12 T. C. 1139.....	11

STATUTES	
Internal Revenue Code, Sec. 117 .....	19, 22
Internal Revenue Code, Sec. 117(a) (1).....	4
Internal Revenue Code, Sec. 117(j).....	2, 4, 20
Internal Revenue Code, Sec. 117(j) (1).....	21

TEXTBOOKS	
25 Corpus Juris Secundum, p. 7.....	3
Cumulative Bulletin 1946-2, p. 30, I. T. 3815.....	4
Cumulative Bulletin 1-1, p. 72, I. T. 1368 .....	4

IN THE  
**Supreme Court of the United States**

October Term, 1952

No. 290

ERNEST A. WATSON and M. GLADYS WATSON,

*Petitioners,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

On Writ of Certiorari to the United States Court of Appeals  
for the Ninth Circuit.

**REPLY BRIEF FOR THE PETITIONER.**

**Introduction.**

The brief for the respondent is founded upon one premise which when it is accepted, the conclusions drawn in the brief follow as a matter of course. The assumption is that the immature fruit on the trees actually was an existing fruit crop. Such was not the case. The green globules upon the tree similar to the blossoms and the other parts of the living tree were no more than the evidences or expectancy of a mature crop which would come into existence at its earliest some three or four months in the future. The parties made a lump sum sale and the Tax Court erred in concluding that the parties were dealing with a crop of fruit as such. Each party had in mind the

expectancy of the crop anticipated for the year 1944 as well as the annual crops for subsequent years. It was with the *expectancy* of a fruit crop that the parties dealt and not with a crop as such.

Counsel for respondent states that the Tax Court found as a fact that the immature crop was being held primarily for sale to customers and further that such a holding is ordinarily a fact question (Br. 26). The findings of fact of the Tax Court do not contain this statement. The reference in the brief of the respondent [R. 47] is to a statement in the opinion which appears to be based in part upon the assumption made by the Tax Court that farmers generally treat their crops from the time they come into recognizable existence as something apart from the land. The cases cited in respondent's brief (Br. 26) involved the fact question as to whether or not the sales activities of the taxpayer constituted a trade or business, a question which is not present in the instant case. We submit that the question here presented is principally a question of law involving the proper construction of Section 117(j).

## I.

**Under the Law of the State of California and a Vast Majority of the Other States, the Growing Crops Are Held to Be Part of the Real Property Where a Conveyance of the Real Estate Is Made.**

The respondent in his brief points to a supposed variety of views among the states and in California as to whether a growing crop is real property or personal property and suggests this as a reason for disregarding the law of California (Br. 34, 35). Insofar as the State of California goes, the decisions have uniformly and consistently held that under the facts in the instant case, *i. e.*, a con-

veyance of land without any mention or reservation of a crop, that the crop partakes of the nature of the realty and for that reason passes to the purchaser under the deed. The fact that under certain circumstances not involved in this case a growing crop may be treated as constructively severed from the land and treated for limited purposes as personal property, can have no bearing here. The only exceptions in California law referred to in the opinion of the Tax Court [R: 33-41] were cases involving chattel mortgages where, by express statutory provision, the growing crop can be mortgaged as a chattel. That a growing crop is treated differently for such purposes is immaterial when the transaction under consideration is a sale of real estate. Respecting the law of other states, the Tax Court refers to only three states which do not follow the general rule, and in all except Georgia, it appears that where the facts involve a conveyance of land, that the growing crop passes under the conveyance as part of the real property. It is not controverted that under the general law of the vast majority of the states growing crops pass under the deed of conveyance as part of the realty. Corpus Juris Secundum, Vol. 25, page 7, states:

"The general rule is that crops attached to the land at the time of a sale or conveyance of the land so far partake of the nature of realty that they pass to the purchaser by the sale or conveyance as appurtenant to the land, unless they are reserved or excepted, as is stated in §7 *infra*, or are covered by certain exceptions known to the law, such as a severance by deed or other valid contract, or mortgage, or as being the crops of tenants. \* \* \*

4

II.

**The Long Continued Silence of the Commissioner of Internal Revenue Indicates It Was the Administrative Policy That No Allocation Between Trees and Growing Immature Crop Should Be Made and That Such Sales Should Be Treated as Sale of Capital Assets.**

Respondent's Brief (Br. 42) indicates that the taxpayers first began to urge that capital gain treatment was extended to growing crops after enactment of Section 117(j) of the Internal Revenue Code enacted as a part of the Revenue Act of 1942. It is true that for a period of four years, from 1938 to 1941, Section 117(a)(1) of the Internal Revenue Code excluded from the definition of capital assets, depreciable property, and for those years it is evident that a taxpayer could not assert a capital gain with respect to the sale of an orange tree (depreciable property) or any of its component parts. However, the capital gain provisions have been in the statute ever since 1921 and the definition of capital assets included both land and improvements held for business purposes. Therefore, if the Commissioner's policy was to require an allocation between land and trees and growing crop, he should have so ruled shortly after the adoption of the Revenue Act of 1921 when the problem would first be presented, and not in 1946 when he issued his ruling (*I. T.* 3815, Cumulative Bulletin 1946-2, p. 30). - (Note: ruling applies only to oranges—no apparent statement on other crops.) The long continued silence of the Commissioner indicates that no allocation between trees and crop was ever intended. This is further borne out by the ruling of the Commissioner, *I. T.* 1368, Cumulative Bulletin I-1, page 72, where the Commissioner ruled that a growing crop is not in-

ventoriable for the reason that the amount and value of such crops cannot be determined. His long continued silence on this question shows that it was the administrative policy not to tax the immature crops at ordinary income tax rates but rather as a part of the trees, a capital asset.

### III.

#### **The Green Unsevered, Immature Oranges Were Not and Could Not Be Property Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of Her Trade or Business.**

The real issue in this entire proceeding is whether the seller sold and the purchaser acquired the immature fruit as a crop of oranges. Respondent's Brief is built upon the premise that this is the transaction which took place. The brief argues that this must follow principally from the evidence in the record that Pogue was induced to purchase the entire property because he estimated he would be able to sell the current season's crop of oranges for some \$120,000.00, and it was therefore apparent that these oranges were an important item or element in the lump sum transaction. Respondent therefore concludes that it must be assumed that the immature crop was sold by petitioner and purchased by Pogue *as a crop of oranges*.

On September 11, 1944, petitioner gave a deed to Pogue which described the land, but made no mention of either the trees or the immature crop. The deed merely described the land.

The green globules then on the trees, which evidenced that a crop of oranges might later be produced, were as much a part of the trees as the leaves. Chemically, they were similar to the leaves, and, to some extent, functioned

like the leaves in sustaining the trees. Also, like the leaves, and the other component parts of the trees, they had no present value, except, and unless, they remained attached to and a part of the trees for some three to four months longer; and they would never have any value, at any time in the future, unless weather and other unforeseeable conditions were such as to enable them to mature and become oranges.

It is, therefore, clear that, under the law of California, the immature crop passed to the purchaser, not because it was sold *as a crop*, but in like manner and for the same reason as did the leaves, the branches, the roots and the other component parts of the trees. It is also clear that these globules did not have a separate or intrinsic value, *in and of themselves*, which would justify the conclusion that a part of the lump-sum consideration was paid for, their purchase, *as a crop*, ~~what is~~ as something separate and apart from the other component parts of the trees.

In fact, the only thing of value, insofar as these globules are concerned, and which, therefore, could have been the subject of a separate bargain and sale, was the *expectancy* that they would later become a marketable product, to-wit: oranges. And, plainly, at the date the grove was sold, these green globules had not matured to the point where it could be said, in any proper sense, that they were "oranges." Oranges are defined by Webster's New International Dictionary as: "The nearly globose fruit of certain trees"; and "fruit" is defined as: "The edible \* \* \* product of a perennial or woody plant." The globules, which constituted the immature crop here, were still an integral part of the trees—not an "edible product," nor even a "product," which those trees had already produced.

A. The Fact That the Crop Expectancy Constituted an Item of Value in the Lump-sum Sale Does Not Mean That Petitioner Therefore Was Selling a Crop of Oranges.

If the globules had reached the stage of maturity where they were oranges, then they would have had a value in their own right, and would, for tax purposes, have been considered as a separate property, irrespective of whether they were, or were not, so classified under California law.

However, the Tax Court does not contend that these globules had reached that stage of maturity. While it refers to them as "oranges", yet, it concedes that the crop was immature. But it nevertheless concludes that the globules, which constituted that crop, were sold as a crop of oranges, because:

"\* \* \* in the instant case the oranges, exclusive of the land, trees and improvements, did in fact constitute a distinct and important item or element in the lump sale which occurred \* \* \*." [R. 44.]

And,

"During the negotiations \* \* \* (it was) estimated that the crop on the trees would be approximately 70,000 loose boxes of oranges, *normal crop conditions thereafter being granted.*"<sup>1</sup> [R. 44, 45.]

And, because

"As far as Pogue was concerned, the quantity and condition of the oranges, plus the price anticipated when the crop should reach maturity, supplied to him the controlling inducement for buying the entire property at the price paid, and for cash." [R. 45.]

Thus, it is plain that the Tax Court takes the position that there was a "short" sale of an as-yet-unproduced crop of oranges.

<sup>1</sup>Emphasis supplied.

There can be no doubt that the expectancy that these globules would later become marketable oranges induced Pogue to pay \$197,100.00 for the "entire property," including the grove. That is evidence by the fact that, shortly before he made the purchase, he had estimated that the trees would produce approximately 70,000 loose boxes of oranges, and, upon the basis of that estimate, had figured he would recoup some \$120,000.00 of his investment from the sale of those oranges. And this fact, coupled with the fact that he had declined to pay the same price for the grove in June, amply warrants the conclusion that the value he placed upon the crop expectancy induced him to pay substantially more for the property than he would have paid without that expectancy. But, clearly, these facts are not determinative of whether (a) he invested that excess in the immature crop, *as a crop of oranges*, or (b) whether he invested it in the grove, *i.e.*, the *land and trees*, because of their current crop expectancy. In other words, these circumstances merely show the inducement for the lump-sum purchase—not whether, in and by that lump-sum transaction, there was a bargain and sale of the immature crop, as such. And, under these circumstances, it certainly could not be said, as the Tax Court does, that "Pogue was buying oranges" and that petitioner and her brothers "were selling their crop of oranges for cash in hand." [R. 45.] Obviously, if the crop, as a crop, was a subject of the barter and sale, it was the *immature* crop which was being bought and sold—not "oranges" or a "crop of oranges," which was not presently in existence, and which might never come into existence.

Nor is the fact that "the oranges, exclusive of land, trees and improvements, was a distinct and important item or element in the lump sale which occurred" [R. 44],

determinative of whether the crop was sold, either as an immature crop, or as a crop of oranges yet to be produced. While here again the Tax Court speaks of the immature crop as though it had already matured and become oranges, yet, what it means, or should mean upon its own findings of fact,<sup>2</sup> is that the expectancy that the trees would produce oranges was an important "item or element in the lump sale." By referring to this *expectancy* as "oranges", it implies that it *must* be assumed that the immature crop was sold as oranges, whereas the facts do not support the conclusion that there was a bargain and sale of the crop, even as an immature crop, much less as a crop of *oranges*. For example, it takes two to make a sale, and it is evident that petitioner was not selling oranges. True, petitioner agreed with Pogue in respect to the "quantity and condition" of the oranges the grove could be expected to produce, "*normal crop conditions thereafter being granted.*" But she did not grant that crop conditions thereafter would be *normal*. In fact upon the basis of her past experience with the grove, she anticipated that "crop conditions" *would not be normal*. She thought it probable that frost would kill, or materially damage, the immature crop before it could mature and become *oranges*; and it was only on that account that she was still willing to sell the grove to Pogue in August for the same price the real estate broker had offered it to him in June, some two months earlier. Certainly, she would not have done this if she and Pogue had been bargaining over the sales of oranges, because it is evident that the chance that the grove would bear a crop of oranges was greater in August than it was in June.

<sup>2</sup>"Navel oranges in the Exeter area generally mature and are ready for picking early in November." [R. 26.] The lump-sum transaction occurred three months earlier, on August 10.

In other words, under the circumstances here, the fact that petitioner and Pogue estimated the quantity and quality of the oranges, *which might be produced*, does not warrant the Tax Court's assumption that they must have agreed upon the value of the crop expectancy (which it calls "oranges") and that they must, therefore, have included the amount so agreed upon in the lump-sum consideration as the sale price of the crop. And there is not even any contention that they did that. The only point the Tax Court makes is that Pogue was induced, by his *unilateral* appraisal of the value of the crop expectancy to buy the "entire property" in August at the same price at which he refused to buy it and at which it was offered to him in June [R. 21-22].

The foregoing circumstances merely show that the difference of opinion between the parties, as to what crop could be anticipated, was the only reason they were able to agree upon a sale price for the "entire property." Yet, as pointed out above, the Tax Court implies that these facts support its conclusion that there was a bargain and sale of the crop expectancy (or rather, the green globules which evidenced that expectancy), *as a crop of oranges*. Under these circumstances, it is an anomaly to conclude that the parties bought and sold a crop of oranges, when the actual motivation for the bargain was the *uncertainty* as to whether a crop of oranges would, in fact, *ever be* produced. It is clear there was no mutuality or meeting of the minds of the parties as to the sale of any crop. As indicated above, the seller anticipated a freeze whereby there would be no crop, whereas the buyer was willing to take a chance and thought from his unilateral appraisal that the crop would be worth \$120,000.00 to him.

Clearly, this conclusion is not tenable. And the fact that Pogue's unilateral appraisal of the current season's crop expectancy induced him to buy the "entire property," and pay more for it than he otherwise would, certainly does not warrant the conclusion that he purchased the immature crop, as a crop—much less that he purchased it *as a crop of oranges*. For example, suppose Pogue had shared petitioner's view with respect to the likelihood that this immature crop could never mature on account of frost. And suppose also he had thought there would be a bumper crop of oranges, and very high prices, the *following* season. And, assume further that this conclusion upon his part induced him to buy the grove, and pay "X" dollars more for it than he otherwise would. In that event, would the Commissioner contend, or the Tax Court hold, that petitioner had had a crop realization for the *following* season, because, in Pogue's opinion, the speculative value of the crop expectancy for that season was "X" dollars, and because that fact had induced Pogue to buy the grove? Or, suppose Pogue had overestimated the quantity of the current crop of oranges, or the price he would receive for them, some three months later when and if they became oranges. In that event, would the Commissioner have approved a loss deduction to Pogue upon the ground that he (Pogue) had not recovered as much of his investment in the "entire property" as he had anticipated?

Or, looking at the cases of *Isaac Emerson*, 12 T. C. 875, and *Fawn Lake Ranch Co.*, 12 T. C. 1139, which the Tax Court rejected as having no relation to the instant case, suppose a taxpayer, who was in the business of selling cattle, culled from his breeding herds, certain

cows and offered them for sale. Suppose also that certain of those cows would give birth to calves in about three months, "*normal (physiological) conditions thereafter being granted.*" Also assume that the purchaser was induced to buy those cows because he expected to recover most of his investment from the sale of the calves when, and if, they were born. In that case, would the Commissioner contend that a portion of the sales price of the cows should be allocated to the non-existent calves, merely because the cows were expectant mothers? Or, if the normal conditions, upon which the purchaser had relied, had not happened and some, or all, of the calves had not been born, would the Commissioner allow the purchaser to deduct a loss because he (the purchaser) had thought that he would recover a part of his investment in the cows from the sale of the calves, when and if they were born? And would his rights, or those of the seller, have been any different by reason of the fact that he had set up on his books, as the cost of such unborn calves, the amount which, in *his opinion*, represented the speculative value of the cows' pregnancy?

These examples make it clear that the *inducement* is not determinative of *what* was purchased. And the following example will even more clearly illustrate the fact that the purchase price must be allocated to the property which is purchased, rather than to the inducement which motivated the purchaser to enter into the transaction. For example, suppose a taxpayer purchases a hotel site because of the scenic view that lot will afford, the hotel he

intends to build; and suppose he pays \$1,000.00 more for the lot because of that view. Clearly, he acquires the scenic view, which induced him to purchase the lot. And it is equally clear that he paid \$1,000.00 for that view. But, nevertheless, the total consideration is allocated to the lot, as its cost, because there could be no doubt, in such case, that he purchased the lot *because* of its view. In other words, the scenic view merely *appreciated the value of the lot* to the extent of \$1,000.00; and, insofar as the seller is concerned, that appreciation was realized from the sale of the lot—not the view.

It is plain, therefore, that if Pogue purchased the land and trees because he expected the trees to bear a crop of oranges some three months later—and, in effect, that is what the Tax Court finds—then the additional amount he paid on account of that crop expectancy represents appreciation, which petitioner realized from the sale of such land and trees—not the cost of the non-existent crop of oranges from which Pogue expected to recover a part of his investment.

The immaturity of the crop is, of course, necessary to this conclusion, because, if the crop on the trees had reached the stage of maturity, where, for all practical purposes, its harvest was assured, then, in that event, even though it went with the grove as a part of the real estate, there would nevertheless have been a crop realization for tax purposes. This would be true, because, as the Courts have repeatedly pointed out, taxes are levied upon the basis of substance, rather than form; and conse-

quently, since Pogue and petitioner, in that case, would, in reality, merely have been "trading dollars," insofar as a *mature* crop is concerned, it would necessarily follow, from a tax viewpoint, that petitioner had realized the fair market value of her crop, in and through the sale of the "entire property"; and that Pogue had invested that amount in a crop of oranges. In other words, the mere fact that the crop, for all practical purposes, had already matured and *become oranges* would have constructively severed those oranges from the trees, (quite irrespective of whether or not, under California law, they remained a part of the realty). And because of such constructive severance in a lump-sum transaction such as there was here, it could not be questioned that a part of the lump consideration had in fact been paid for the purchase of the crop, as oranges.

But where, as here, the crop had not reached maturity, and where it was purely a matter of speculation as to whether it ever would reach maturity, it must be held, for the purposes of tax law, that there was no sale of the crop, *as a crop*, just as, in the absence of a crop reservation in the deed of conveyance, it is held, for the purposes of conveyancing law, that the crop passed *as a part of the trees*.

It seems clear, therefore, that the Tax Court erred in holding that \$40,000.00 of the lump-sum was realized from the sale of a crop of oranges. The expectancy of such crop merely appreciated the value of the grove, and that expectancy, which went with the grove, merely induced Pogue to purchase the "entire property."

**B. The Crop Expectancy Is Appreciation in Value of the Land and Trees. The Internal Revenue Code Precludes Allocation of This Speculative Value to the Current Crop.**

This brings up the question whether for tax purposes, the appreciation which this expectancy gave to the grove, *i. e.*, to the land and trees, should be allocated to the current crop, notwithstanding that it passed to the purchaser *as a part of the realty*. The land and trees also passed to the purchaser as a part of the real estate described in the deed, and since a separate cost basis must, nevertheless, be allocated to each of those properties, it may be asked why the same should not be true with respect to the crop, which, like the land and trees, passed to the purchaser as a part of that same real estate?

The answer is that the Internal Revenue Code requires that an allocation be made as between the land and trees, because the land is non-depreciable and the trees are depreciable property. But, there is no provision in the Code requiring an allocation as between the component parts of the trees.

In fact, under the provisions of the Code, no such allocation could be made—at least logically. This is true because the current crop expectancy, which induced the purchase here, differs from the crop expectancies for subsequent seasons only in the amount of its speculative value; and that is difference in *degree*—not in *character*. The current expectancy, which the Tax Court erroneously calls "oranges," did not come into existence in May when

the trees bloomed. The expectancy that the trees would bear oranges during the current season, as well as in all other seasons, came into being years before when the trees themselves reached bearing age, and their healthy condition evidenced that they could be expected to bear oranges, each and every season, "*normal crop conditions thereafter being granted.*" At that time, and with such crop conditions *being granted*, experienced fruit growers could estimate the quantity and quality of the oranges, the trees could be expected to bear each and every season during their useful lives. The appearance of the blossoms in the current season, the later "setting" of the crop and the still later appearance of the green globules merely evidenced the extent to which crop conditions had been normal during the current crop season. And, because crop conditions had been normal that season, certain of the crop hazards had been successfully passed, and, therefore, the probability that the current crop would mature and become oranges was greater. This fact, coupled with the fact that harvest time became nearer with the happening of each of those events, merely gave the crop expectancy a progressively higher speculative value. But none of these events changed its character. It still was, and would remain, only an expectancy until the harvest of the current crop was assured. It follows, therefore, that being the same in character as crop expectancies for subsequent seasons, the current crop expectancy should be treated the same as the crop expectancies for succeeding crop seasons. If, however, a speculative value is as-

signed to the current expectancy and allocated to the immature crop, as its sale price, then, by the same token, the speculative values of the expectancies for subsequent seasons should likewise be allocated to the crops for those seasons as their sales prices. However, since the trees themselves have no value, save and except that which is derived from the sum total of their crop expectancies, this would result in the entire sales price of the grove being allocated between the land and the several crops the trees were expected to produce; rather than between the land and the trees, as the Code provides. If this were done, the part of the sale price not allocated to the land would be recovered by the purchaser in *unequal* amounts<sup>3</sup> over the useful life of the trees, either (a) as crop losses, or (b) as cost deductions from crop realizations—not, as the Code provides, by *equal* depreciation deductions over the useful life of the trees.<sup>9</sup> Hence, in effect, the Code precludes, rather than provides for, the allocation of the speculative value of the current crop expectancy to the current crop.

It seems clear, therefore, that the current crop expectancy was not sold as a crop of oranges. It merely gave the land and trees a greater value than they otherwise would have had. And, therefore, the amount Pogue paid because of that potentiality represents appreciation which petitioner realized from the sale of those assets.

---

<sup>3</sup>Each successive season's crop expectancy has a lesser present speculative value than the expectancy for the next preceding season.

C. The Green Globules on the Tree Were Neither Inventorial Property nor of the Kind or Character of Property Which Petitioner Held Primarily for Sale to Customers in the Ordinary Course of Her Trade or Business.

But even if, for purposes of argument, we assume that the speculative value of the current crop expectancy should be allocated to the immature crop, nevertheless, the amount so allocated could not be classified as ordinary income. As has been pointed out above, the globules which constituted that crop were not the kind or character of property which petitioner held primarily for sale to customers in the ordinary course of her trade or business, and, admittedly, they were not property of a kind which would properly be includible in her inventory. And the Tax Court, in effect, concedes these facts.

There were two phases of petitioner's business. *First*, she owned and operated her grove for the purpose of producing oranges in and through the care, maintenance and cultivation of such grove. *Second*, she was in the business of selling those oranges after, but only after, her grove produced them. Clearly, therefore, until oranges were produced, petitioner was holding her immature crop as a part of the trees for the sole and only purpose of producing the oranges, which when mature she thereafter began holding them for sale. And, to paraphrase the Tax Court's language, we are unable to see how the holding of the immature crop primarily for the purpose of producing the only marketable article petitioner was in the business of selling could be changed to a holding

for some other purpose in and by the sale of the assets, which were being used to produce such marketable product.

The lump sale transaction merely changed the ownership of the grove without working any change in the character of the crop. As a result of that transaction, Pogue continued to hold the same immature crop for the same purpose for which petitioner had previously held it, namely, for the purpose of using the assets, which he had purchased, to produce the mature oranges, and hence, the income, the prospect of which had induced him to purchase those assets.

While it is plain that Section 117 refers to the kind or character of the property, which is the subject of the holding, and not to the mode or manner of its sale, and while it is also plain that the fact that such property is real estate is not determinative of whether or not it is held for sale, yet, neither of those principles is violated here when a lump-sum sale is made of the grove, which carries the immature crop with it as a part of the trees. These transactions merely determine *what* property is to be considered in respect to the question of whether it is the kind or character of property which petitioner holds primarily for sale. And that question is then determined by comparing that property with the properties which petitioner has in the past held for sale in the ordinary course of her trade or business.

It is plain, therefore, that California law is determinative of the issue here, because, under that law, there

was no sale of the crop, as a crop of oranges. Under California law, the immature crop passed to Pogue as a part of the trees, and, therefore, if any income is realized by petitioner, in and from the speculative value of the current crop expectancy, the amount so realized must be allocated to the property which actually passed under California law, namely, the *immature* crop.

It follows that, even if there were a crop realization, such realization was from the immature crop, which was an integral part of the trees. Admittedly, the trees and land were used in the first phase of petitioner's business, and, since the Tax Court concedes that petitioner was not in the business of selling her immature crops, the immature crop here in question was not the kind or character of property which she held primarily for sale to customers. Hence, even if there were a crop realization, the income so realized is capital gain under Section 117(j).

The Court of Appeals, Ninth Circuit, followed the majority opinion of the United States Tax Court. It failed to recognize that petitioner's activities were dual in nature: First, she owned and operated her grove for the purpose of growing ripe mature oranges, and secondly, she was in the business of selling these oranges after her grove had produced the mature fruit; that the land and the trees (including all of its component parts—the roots, trunks, leaves, and little green globules) used in her trade or business were sold to Pogue for a lump sum before she had any fruit to sell in the ordinary course of her business of selling ripe mature oranges. The Court

of Appeals followed the fallacious theory that the immature fruit was a crop of oranges being held for sale, and assumed for some unexplained reason that as soon as there was some tangible evidence that there would be a potential crop, that such potential crop immediately became property held for sale to customers. As a matter of fact, the immature fruit was worthless at the time and would not be salable property for three or four months after the grove was sold to Pogue. The Court of Appeals further assumed that the decision to sell the grove as a unit apparently changed the character of the holding of the crop and that Section 117(j)(1) was "not satisfied for the crop was not held in the non-business sale character for six months required by that section," without stating when the holding period started or how the "character of the holding of the crop" was changed.

There was a potential crop on the trees when the unit sale of the grove was made—the same potential crop was on the trees after Pogue purchased it. The character of the property never changed. The immature crop was a part of the real estate until three or four months later when it matured and was picked by Pogue. Petitioner held the land and trees with all of its component parts for use in her business of growing and selling mature oranges. She held no fruit for sale to customers up to the time the unit sale was made to Pogue.

It is obvious that the land and the trees, including the immature fruit on the trees is property used in the peti-

tioner's business of selling mature fruit, and the profit realized on the sale thereof is entitled to the capital gains treatment under Section 117.

#### IV.

#### **All of the Property Sold by Petitioner Was Held for More Than Six Months.**

The final point made in respondent's brief is in the alternative that the green globules on the tree which counsel for the respondent call "the existing orange crop" were not held by taxpayer for more than six months. As has been previously pointed out, the existing orange crop came into being in November and December of 1944 when the fruit matured, after petitioner had disposed of her interest in the grove. Prior to that time the crop had no existence. The blossoms and the green globules were not a crop, and consequently a holding period could not commence from the date upon which they appeared on the tree or at the time petitioner listed the property for sale with the real estate broker. These component parts of the tree were used by taxpayer in the growing or producing phase of her business, and the holding period is the holding period for the land and the trees which the respondent concedes was a period in excess of six months.

**Conclusion.**

For the reasons set forth herein and in the opening brief of petitioner, the decision of the Court of Appeals is erroneous and should be reversed.

Dated January 30, 1953.

Respectfully submitted,

A. CALDER MACKAY,

*Attorney for Petitioner.*

ARTHUR MCGREGOR,

HOWARD W. REYNOLDS,

ADAM Y. BENNION,

RICHARD N. MACKAY,

CHARLES J. HIGSON,

*Of Counsel.*

Service of the within and receipt of a copy thereof is hereby admitted this.....day of January, A. D. 1953.

---

---